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SUBJECT: BIG COMPROMISES PUSH JAPAN-THAI FTA INTO FINAL STAGES

REF: BANGKOK 2298

11. (U) Sensitive but unclassified. Please treat accordingly.

12. (SBU) Summary. As the negotiation of the Japan-Thailand Economic Partnership Agreement (JTEPA) enters its final stages, Thai and Japanese negotiators have moderated some key demands to avoid a stalemate. A Japanese economic official involved in the negotiations said the last round of talks in March ended in deadlock over a few major issues -- particularly steel and auto tariffs. Quiet consultations over the last two months may have resulted in an agreement that packages most of the issues in a first round, and a few, contentious issues left for negotiation in a later second round. Nevertheless, local Thai industrialists and steelmakers have publicly questioned the wisdom of this agreement, urging the RTG to focus on "mutual benefits." As Thai negotiators have exhausted their mandate, the final and most difficult parts of the negotiations have been elevated to the highest political levels -- Prime Minister Thaksin and Deputy Prime Minister and Finance Minister Somkit Jatusripitak -- a move which probably foreshadows the treatment of other free trade agreements currently under negotiation. While this FTA shows that it is possible to negotiate a deal with Thailand within a short timeframe, precedents set in Thailand's FTA with Japan will not be helpful as we seek a comprehensive, single undertaking FTA with Thailand. End Summary.

Japanese Investors Carry -- and Expect -- Weight in Thailand

13. (SBU) For more than 25 years, Japan has been the largest single source of FDI in Thailand. Much of Thailand's export-driven growth was fueled by Japanese investors, who saw Thailand as U.S. investors saw Mexico: an inexpensive and stable environment for increasingly sophisticated manufacturing. In 2004, FDI from Japan totaled 733 million USD, and in 2003, 816 million USD (US FDI inflow was 394 million USD in 2004). While Japan trails the U.S. and the EU in market share of Thai exports, Japan is by far the largest source of imports to Thailand, fueling Japan's continuing investments in manufacturing. Befitting their status as the single biggest foreign participant in the Thai economy, Japanese officials and commercial interests have repeatedly asked for preferential trade and investment provisions. Aside from reducing tariffs on industrial goods, Japanese officials in particular have sought to receive national treatment on investment, similar to the treatment Americans receive under the Thai-U.S. Treaty of Amity and Economic Relations (AER).

March Round Ends in Stalemate

14. (SBU) The last round of talks was held at the end of March in Khao Yai National Park in Thailand. The first day of talks focused on agriculture. In the September 2004 Asia-Europe Meeting (ASEM) meeting, PM Thaksin agreed to exclude rice from the discussions, which had proven the biggest sticking point until then. According to a Japanese official, in Khao Yai RTG negotiators moderated their demands for market access on raw chicken, tapioca, and sugar. Japan agreed to cut the current 6% tariff on Thai chickens in half, boost annual tapioca starch quotas to 200,000 tons from 70,000, and end the current 9.6% tariff on canned tuna within five years. Japan has also offered to cut tariffs on several fruit products and shrimp, and expand quotas in some other products, such as canned pineapple. At the end of this day of talks, the two chief negotiators signed a "record of discussion" announcing the provisional agreement on agricultural goods.

15. (SBU) During the industrial goods discussion the next day, Japanese negotiators asked for the immediate elimination of tariffs on completely-built-up (CBU) cars with engines larger than 3000cc (now at 80%), a reduction of tariffs on CBU cars with engines less than 3000cc by 2010, and the elimination of all tariffs on automobile parts, automobile steel, electrical appliances, moulds, and machinery from Japan. Thai negotiators countered by offering gradual tariff reductions over 15 years for auto parts, the maintenance of steel

import tariffs for another 10 years, after which they would be phased out by the 15th year, and have offered to negotiate the CBU car issue in a second round of negotiations over the next 3-5 years.

RTG Compromise a "Serious Miscalculation"

16. (SBU) According to a Japanese official involved in the discussions, Thailand calculated that by compromising on several of its most contentious agriculture requests, Japan would return the favor by moderating some of their demands in the industrial goods section. The Japanese official said that the Thai negotiators had made a serious miscalculation. The official explained that the two main Japanese ministries engaged in the negotiations, the Ministry for External Trade and Industry (METI) and the Ministry of Agriculture, Forestry and Fisheries (MAFF) did not cooperate on negotiating strategies, or coordinate big picture gains. Therefore, the Thai compromise on issues important to MAFF earned them no currency on the second day of negotiations with METI. When METI negotiators refused to temper their demands, Thai negotiators grew angry and disappointed; the Japanese official acknowledged that this disappointment was "understandable."

17. (SBU) The following week, the Thai chief negotiator and experienced diplomat Pisan Manawapat told papers, "The ball is in the Japanese court. If METI changes its ambitious and unrealistic attitude, there is a chance that a balanced deal can be reached. Now they are demanding more than what is in my capacity to deliver, so let's allow the high-level policymakers to work it out." Thai officials told Econoff that the provisional agreement on agriculture was not binding, and was predicated on the successful conclusion of the industrial good talks; Japanese officials, who announced the results of the agricultural talks, say that they will not re-open those negotiations.

JTEPA Sparks Public Interest and Controversy

18. (SBU) JTEPA has received widespread coverage in the local press, focused unusually on the disputes between local steelmakers and the Thai government over tariff reductions. Thai steelmakers (see reftel) have complained that they cannot compete with higher quality Japanese imports; Japanese automakers, primarily, maintain that the quality of local steel is not high enough for locally produced vehicles, and high steel import tariffs (between 5-15%) reduce competitiveness. Japanese automakers have moved much of their ancillary parts production to Thailand, and have long sought lower tariffs for imported, high-quality, hot rolled steel, which they say cannot be manufactured in Thailand. (In 2004, Thailand imported over 2 billion USD of steel from Japan, close to 13% of total Japanese imports. Thailand also imported close to 2.8 billion USD of parts and vehicles from Japan last year. On average, Thailand consumes between 12-13 million tons of steel annually; in 2004, 7 million tons were produced locally.) Access to higher quality and lower cost inputs has been made even more important, as tensions with China have spurred Japan's car manufacturers to place greater emphasis on boosting their production in Thailand.

19. (SBU) In recent weeks, anger between Thai steel companies and Japanese automakers has reached a boiling point. Japanese automakers have pressed hard for reduced tariffs on both high-quality steel products -- including car parts -- and automobiles with engines larger than 3000cc, publicly taking their concerns to PM Thaksin. Local steelmakers have accused the Thai government -- and Thaksin in particular -- of "selling out" to Japanese business interests. In turn, Japanese automakers have gone far to reassure the Thai government that they will move forward with major production capacity investments of over one billion USD, no matter which way JTEPA goes -- much to the chagrin of Japanese negotiators who hoped to use this investment as a bargaining chip.

10. (SBU) According to the Japanese official, negotiators have now divided industrial goods demands into two categories: products which can be made in Thailand and products which cannot. Japanese negotiators have focused their requests on eliminating tariffs on products they believe can't be made in Thailand, and a phased reduction for other products. The Japanese official acknowledges that local Thai steelmakers are "furious," especially with their political leadership. Steelmakers have long promoted an ambitious plan to build a 500 billion baht (12.5 billion USD) steel smelting plant in Thailand to develop the upstream capabilities of Thai steel producers. PM Thaksin and other ministers have greeted this proposal with public skepticism, increasing local steelmakers perception that PM Thaksin is "in the pocket" of the Japanese.

11. (SBU) European and American automakers are also wary of lowered steel and vehicle import tariffs from Japan. The Ambassadors of France and Germany issued a public announcement expressing their concern that lowered tariffs on CBU cars will hurt their plants in Thailand, and forestall

further expansion and investment. The heads of 8 non-Japanese automakers in Japan also sent a letter to PM Thaksin expressing similar sentiments. (Note: Thailand granted Australia duty-free status for cars with engines over 3000 cc in the Thai-Australia Free Trade Agreement (TAFTA). Reportedly, GM may export Australian models to Thailand in the future, but Ford has no plans to take advantage of this provision at the moment.) Members of the local Federation of Thai Industries (FTI) have also opposed lowered tariffs on imported cars, fearing that this will hurt the domestic auto industry. European and American auto manufacturers also feel that lower imported steel prices from Japan would work against them, rather than for them. Asked why cheaper steel wouldn't help all local automakers, regardless of nationality, local steelmakers told Econoff that the Japanese traditionally do not sell outside their production chains. (However, Ford, which is a partner in the Auto Alliance Thailand with Mazda, would benefit from reduced tariffs on parts, a fact they do not like to trumpet.) Officially, the RTG opposes ending duties on cars with engines larger than 3000 cc because of fuel consumption and environmental concerns. However, in a meeting with representatives from non-Japanese carmakers, Pisan explained that he had "made this whole argument up on the spot," and was still amused that the Japanese continue to take this position seriously.

The Next Steps are Political

12. (SBU) According to Japanese officials, almost 80% of JTEPA has been completed. Chapters in JTEPA include goods, services, investment, IPR, cooperation, "mutual recognition" (standards), and dispute settlement. A senior Thai negotiator said the Japanese have accepted a positive list approach "for everything." As with other FTAs, the Thai government has insisted that the agreement require no legal changes. Japanese negotiators have largely respected this request, except in one crucial area -- investment. Japanese officials are seeking national treatment rights for investment, similar or near to those enjoyed by Americans under the AER. A Japanese official said that if negotiators do not achieve at least 51% ownership rights, they will not be able to finish the FTA. The official believes that attitudes have changed among Thai officials, and the issue will be taken up again at the end of the month when the two chief negotiators meet again in Tokyo. (Note: A senior Thai official involved in the talks would say only that the RTG will allow majority ownership for "investments in services related to manufacturing.") Concerned over recent RTG trends gradually rolling back the rights and privileges of foreign investors, Japanese negotiators hope to achieve a standstill on investments rules and regulations. Honoring a Thai request, Japanese negotiators have agreed to allow higher or special quotas for cooks and masseurs working in Japan.

13. (SBU) The Japanese official told Econoff that Deputy Prime Minister and Finance Minister Somkit Jatusripitak will travel to Japan during the week of June 13 to meet with senior Japanese officials. The official expected that the two sides would settle the tariff and trade issues during this visit. Reportedly, Japanese negotiators have already backed down on some of their tariff requests, agreeing to "discuss" auto tariff reductions over the next three years. According to this official, PM Thaksin is hoping to sign the agreement by July 2005, with a proposed entry into force date of 1 January 2006. Similarly, Thai officials predict that the agreement will be agreed upon in principle "before Montana," meaning by mid-July.

14. (SBU) Comment: The controversies surrounding JTEPA are normal for any two major trading partners involved in FTA negotiations. For U.S. trade negotiators, the good news is that Thailand is about to demonstrate that it can negotiate a fairly wide coverage FTA with a major trading partner in a fairly short timeframe. On the other hand, several patterns of concern have emerged. First, Thai industry is again complaining over the lack of transparency of PM Thaksin and his government. Second, the most significant issues have been bumped up to the highest political levels, belying the limited mandate of RTG negotiators. The Thai government appears to be willing to sacrifice many of their offensive demands in order to protect key sectors the RTG wants to defend -- including packaging the agreements of the FTA in multiple rounds. In FTA negotiations with Japan and Australia, RTG negotiators have learned that if they wait long enough, their negotiating partners will cave on key issues like positive lists, inclusion of financial services, and even important manufacturing sectors. Undoubtedly, the RTG will bring these "lessons learned" into the Thai-U.S. FTA negotiations -- if they haven't already. Finally, the RTG's success (albeit limited) in obtaining increased labor mobility rights in this FTA will encourage a push for temporary entry provisions in the FTA with the U.S. All in all, precedents set in Thailand's FTA with Japan will not be helpful as we seek a comprehensive, single undertaking FTA with Thailand. End Comment.

BOYCE